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IN THE

Supreme Court of the United States

FEBRUARY TERM, 1973

No. ....72 - 1154

In the Matter
of
BLAIR & Co., INC.,
Debtor.

JOHN P. FOLEY, JR., J. P. FOLEY & Co., INC. and ANITA SALISBURY,
Petitioners,
against
BLAIR & Co., INC. and PATRICK E. SCORESE, as Liquidator appointed by the New York Stock Exchange, Inc. for BLAIR & Co., INC.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TO THE HONORABLE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, John P. Foley, Jr., J. P. Foley & Co., Inc., and Anita Salisbury, respectfully pray for a Writ of Certiorari to the United States Court of Appeals for the

Second Circuit to review a determination of that Court rendered on the 11th day of December, 1972, setting aside an order of the United States District Court for the Southern District of New York entered on March 15, 1972, which confirmed an order of Hon. Asa S. Herzog, Referee in Bankruptcy, dated April 27, 1971, adjudicating Blair & Co., Inc., a Bankrupt, the determination of the Court of Appeals for the Second Circuit directing the Referee aforementioned to vacate the adjudication and dismiss the Involuntary Petition in Bankruptcy.

Opinions Below

1. The opinion of Hon. Asa S. Herzog, Referee in Bankruptcy, is appended hereto in full in Appendix A.

2. The opinion of Hon. Irving Ben Cooper, United States District Judge in the United States District Court for the Southern District of New York is appended hereto in full in Appendix B.

3. The opinion of the United States Court of Appeals for the Second Circuit decided on December 11, 1972, is appended hereto in full in Appendix C. A Petition for Rehearing was denied on January 29, 1973, with no opinion.

4. A Motion for a Stay of Mandate of the United States Court of Appeals for the Second Circuit was granted on February 2, 1973, staying the mandate of the said Court to February 23, 1973, pursuant to Rule 28(c) of said Court.

Jurisdiction

The jurisdiction of this Court is invoked upon the ground that the Court of Appeals for the Second Circuit has rendered a decision by a divided Court in conflict with every other decision rendered by any Court on the same subject,

and in so doing, has thwarted the expresed intention of Congress, and has created a realistic potential for chaos in the field of insolvency where no such potential had previously existed. This is an important question of Federal law, which requires the intercession of, and should be settled by, this Court, as the decision has so far departed from the accepted and usual course of judicial proceedings, as to call for an exercise of this Court's power of supervision.

Question Presented

1. Section 3(a) of the Bankruptcy Act (11 U.S.C. § 21(a)(5)) designates as an Act of Bankruptcy:

> "Acts of bankruptcy by a person shall consist of his having
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> • • •
>
> (5) while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property."

The Court of Appeals in an absolute departure from every text and every precedent involving an interpretation of this Section has reversed an Order of Adjudication upon the ground that a liquidator in charge of the property of the Bankrupt, with all of the powers of a Receiver or Trustee, was not appointed by a Court, but was appointed by contract, and, therefore, did not come within the scope of the above quoted Section.

Statement of Case

Blair & Co., Inc., is a Delaware corporation, which was engaged in the stock brokerage business on Wall Street in New York, as well as in multiple branches throughout the nation. It suffered severe financial reverses in 1969, and

1970, and in the late summer of 1970, decided to terminate its business by liquidation. It entered into a contract with the New York Stock Exchange, by the terms of which the New York Stock Exchange, using the token of a $1,000 loan to Blair & Co., Inc., was given the power to appoint a liquidator to take charge and conduct the liquidation. On or about September 25, 1970, Patrick E. Scorese was appointed liquidator pursuant to this contract, and took over all of the affairs of Blair & Co., Inc., under a broad power of attorney containing all of the powers, and more, of any Receiver or Trustee that could have been appointed by a Court, except that he served without bond, and with no Court control. Petitioning Creditors then filed an Involuntary Petition in Bankruptcy on or about September 29, 1970, alleging a fraudulent conveyance, preferential transfers and the appointment of the Liquidator as Acts of Bankruptcy.

Blair & Co., Inc., and the Liquidator moved for summary judgment seeking to dismiss the Involuntary Petition upon the grounds that the petitioners were subordinated creditors who were not empowered to file such a petition, arguing that Blair & Co., Inc., was not insolvent, and attacking the form of the three Acts of Bankruptcy alleged. There was no dispute as to the actual facts, and Petitioning Creditors cross-moved for summary judgment seeking an Order of Adjudication. Hon. Asa S. Herzog, Referee in Bankruptcy, dismissed the first two acts of Bankruptcy on technical grounds, but held that the appointment of the Liquidator constituted an Act of Bankruptcy under § 3(a)(5) of the Bankruptcy Act. He also held that Petitioning Creditors were bona fide creditors with the right to file the Involuntary Petition, and also held that Blair & Co., Inc., was clearly insolvent. He directed that adjudication be granted, and an order to that effect was entered forthwith.

A Petition to Review was taken to the United States District Court for the Southern District of New York, and

Hon. Irving Ben Cooper, United States District Judge, denied the Petition to Review and confirmed the adjudication. An appeal was taken to the Court of Appeals for the Second Circuit, which reversed, by a divided Court, the previous findings of the Honorable Referee and District Court Judge, Hon. Henry J. Friendly writing the majority opinion, in which he specifically excluded a liquidator not appointed by a Court from the scope of § 3(a)(5). In a dissent, Judge William H. Timbers rejected this conclusion, contending that an interpretation of an act based upon language expressly eliminated from a Statute (in 1926), which results in the defeat of a party, whose position falls squarely within the remaining language, was not the most sensible interpretation of the Act.

The case, therefore, presents to this Court an undisputed set of facts (the questions of the right of the Petitioning Creditors to act as such, and the question of the insolvency having been expressly rejected as issues by the Court of Appeals) to which a question of interpretation of a Federal law must be applied, in the light of the law as it presently exists, and the history of that law as it first evolved and was eventually amended and changed into its present form.

Argument Amplifying Reason Relied Upon for Allowance of Writ

The jurisdiction of this Court is properly invoked on the ground that the order of the Court of Appeals finally determines the Bankruptcy proceeding in that it directs the vacatur of the Order of Adjudication and the dismissal of the Petition.

The question on this appeal is of great public concern, because it creates a legally sanctioned device for fraudulent and collusive dissolutions of insolvent companies beyond the reach of the Federal Bankruptcy Courts. The

liquidation of insolvent companies is, and always has been, a troublesome problem to the business community of this nation. It has been axiomatic that control of liquidations should rest in the creditor body, as it is they, who truly bear the losses of insolvency. The right to interrogate, investigate, and to seek to recover dissipated or fraudulently conveyed assets, is a basic right of creditors. Although Bankruptcy has often been referred to as a means of rehabilitation, it has never lost its basic character of providing a means and a forum through which creditors could assert their prerogative to seek out the causes of insolvency, and to liquidate and seek to obtain a maximum recovery through the medium of their own diligence. Any attempt to interfere with the basic right of creditors to control and supervise liquidations of their insolvent debtors has been consistently and sternly rejected.

It is in the light of these principles that this Court has uniformly held that the Bankruptcy Law is paramount, and the jurisdiction of the Federal Courts in Bankruptcy is essentially exclusive, and

> "that the intent of the bankruptcy law is to place the administration of affairs of insolvents exclusively under the jurisdiction of the bankruptcy courts."

Re: Watts & Sachs, 190 U. S. 1, 27, 28.

The majority opinion of the Court of Appeals is a distinct and abrupt departure from everything that has been written on the question involved on this appeal. In 1941, the District Court for the Western District of Oklahoma held that the appointment of a liquidator, not appointed by a Court, came within the scope of § 3(a)(5). (In re: *R. V. Smith Co.,* 38 F. Supp. 57, 62.) Attorneys and members of the business community had ample reason to presume that the principle of *stare decisis* made this the law of the land. COLLIER ON BANKRUPTCY (V. 1 § 3.502) rely-

ing on the *Smith* case, stated that § 3(a)(5) includes

> "liquidation agents generally who . . . may not be appointed by a court."

This doctrine is enunciated further in § 3.503 thereafter. REMINGTON ON BANKRUPTCY (V. 1 § 157) is to the same effect.

The majority opinion's sudden departure in interpretation of this previously well-established principle constitutes a severe setback to the overriding principle of the exclusivity of the Bankruptcy Courts. Paraphrasing REFEREE HERZOG in his opinion, the decision of the Appellate Court sought to be reviewed here, has in effect held that the exclusive jurisdiction of the Bankruptcy Court can be defeated, and creditors denied the right to select their own trustee to control a liquidation, by the simple expedient of the appointment of a private liquidator by the insolvent debtor itself. It would be strange to hold that the appointment of a State Court Receiver, bonded and under the control of a Court, or the designation of a trustee through a Deed of Trust, or the execution of an Assignment for the Benefit of Creditors, may all be superseded by reason of the paramount and exclusive jurisdiction of the Bankruptcy Courts, yet, the private appointment of a hand-picked liquidator, selected by the insolvent itself, cannot be so superseded. Such a holding opens a broad highway for corruption and fraud. Officers and directors of insolvent companies could secrete and dissipate assets and make fraudulent conveyances without fear of investigation by a liquidator of their own choosing. Certainly, this is not the intent of the laws of the land, and it is certainly not in the best interests of the business community, and it is extremely doubtful that Congress ever intended such a result.

Congress in enacting § 3(a)(5) of the Bankruptcy Act in its present form in 1938, specifically asserted one of its purposes to be to broaden "the scope of this act of bank-

ruptcy in order to reach the widely prevalent abuse of collusive equity receiverships". This purpose is justifiable and duly warranted, but it is inconsistent to interpret a law enacted with such intent, as to hold that while it justifies the filing of a Petition in Bankruptcy by reason of the appointment of a collusive equity receivership by a friendly court, it could not be used as a basis for superseding a collusive private liquidation.

In the instant case, a stock brokerage concern, which was a member of the New York Stock Exchange, and whose principal officers were members of the New York Stock Exchange, takes the position that while a State Court Receivership could have been the basis for the filing of an Involuntary Petition in Bankruptcy, the appointment of a liquidator, privately selected through joint agreement between the insolvent debtor and the New York Stock Exchange, which could possibly be as collusive as any possible collusive equity receivership, if not more so, would not justify and sustain an Involuntary Petition in Bankruptcy.

Such a contention flies in the face of the established policy granting exclusive jurisdiction of liquidations in the Bankruptcy Courts. The opinions of the learned Referee and the Court on the District Court level clearly maintain that any difference between a Court-appointed Receiver and a privately selected liquidator did not warrant a distinction in the legal effect thereof, insofar as each constitutes an act of bankruptcy within the intent of § 3(a)(5). Certainly, to hold that a liquidator, who is expressly empowered to give good and clear title to real and personal property, differs from a receiver or a trustee in whom title may vest only by virtue of long-established common law or a Statute, would be to indulge in meaningless semantics, and to consider form greater than substance.

The concept of the appointment of a receiver or trustee in charge of a debtor's property as an act of bankruptcy

was first enacted in 1903, and it defined such appointment by using the phrase "under the laws of a State, or a Territory, or of the United States". However, in 1926, Congress expressly repealed the words, "under the laws of a State, of a Territory, or of the United States", yet the majority opinion disregarded this repeal, and in effect holds that it is still part of the existing law, although it plainly is not.

Quoting Mr. Justice Trimble in his dissenting opinion:

> "where the effect of such a reading is to hold in favor of a party whose position relies on language expressly eliminated from the statute, and thereby to defeat a party whose position falls squarely within the remaining language, I should have thought that we would construe the amendment in the most sensible, rather than the narrowest manner."

In effect, the majority opinion contends that that which was repealed in 1926, was not repealed, and has decided this case on the basis of such non-repealer. It is respectfully felt that this Court should review such a narrow and unlikely conclusion.

CONCLUSION

The writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A—Opinion of United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 144—September Term, 1972.

(Argued November 9, 1972 Decided December 11, 1972.)

Docket No. 72-1554

In the Matter

of

BLAIR & Co., INC.,

Debtor.

BLAIR & Co., INC. and
PATRICK E. SCORESE, as Liquidator appointed by the New York Stock Exchange, Inc. for
BLAIR & Co., INC.,

Appellants,

—against—

JOHN P. FOLEY, JR., J. P. FOLEY & Co., INC. and
ANITA SALISBURY,

Appellees.

Before:

FRIENDLY, *Chief Judge,*
MANSFIELD and TIMBERS, *Circuit Judges.*

Appeal from an order of the District Court for the Southern District of New York, Irving Ben Cooper, *Judge,* denying a petition to review an order of Referee Asa S.

Herzog adjudicating Blair & Co., Inc. an involuntary bankrupt. Reversed, with instructions to direct the referee to vacate the order of adjudication.

HARVEY R. MILLER, ESQ., New York, N.Y. (Charles Seligson, Esq., Weil, Gotshal & Manges, and Michael L. Cook, Esq., New York, N.Y., of Counsel), *for Patrick E. Scorese, Liquidator-Appellant,*

—and—

(Mudge Rose Guthrie & Alexander, New York, N.Y., of Counsel), *for Blair & Co., Inc., Debtor-Appellant.*

LEO H. RAINES, ESQ., New York, N.Y., *for Appellees.*

FRIENDLY, *Chief Judge:*

This appeal raises an interesting question concerning the interpretation of § 3a(5) of the Bankruptcy Act. Under that subsection it is an act of bankruptcy if any person

> (5) while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property.

Blair & Co., Inc. (Blair), a Delaware corporation, was engaged in the general brokerage and commission business, with its principal office in New York City. It was a member of the New York Stock Exchange (NYSE) and two other exchanges. At the time of its adjudication as an involuntary bankrupt, it had some 28,000 customer accounts and held more than $75,000,000 in securities, some $40,000,000 of which, including those of customers, were pledged to banks as collateral for loans of approximately $30,000,000.

As a result of operating losses and a concomitant shrinkage of capital, Blair, in the early summer of 1970, began a program of self-liquidation, which involved the transfer of customer accounts to other broker-dealers and the delivery of securities to customers requesting this. Allegedly Blair believed at the time that its resources were sufficient to enable it to discharge its obligations to all customers and general creditors. Late in September, Blair concluded that implementation of the program might require the assistance of the Special Trust Fund which NYSE had established in 1964 to avoid the bankruptcy of member firms, with attendant hardship to their customers and loss of confidence in the securities markets. See Constitution of the New York Stock Exchange, art. XIX, § 1.

On September 21, Blair and certain other participants entered into an argeement with NYSE whereby the trustees of the Special Trust Fund would make loans and guarantees to assist Blair's customers against loss. In accordance with standard practice, the agreement provided that, immediately upon the first loan, guarantee or advance by the trustees, NYSE should have the right to appoint a Liquidator of its own choosing. Paragraph VIII of the agreement described the powers and duties of the Liquidator as set forth in the margin.[1] Simultaneously Blair executed an-

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[1] Immediately following his appointment by the Exchange, the Liquidator shall take control of the business and property of the Corporation for the purpose of liquidating the business of the Corporation and shall proceed as follows in connection with the liquidation:

i.) he shall promptly take such steps as he may deem practicable to reduce the Corporation's operating expenses and to dispose of the Corporation's salable assets;

ii.) he shall have power to retain independent public accountants, consultants, counsel and other agents and assistants and shall have power to augment and reduce or eliminate the staff of the Corporation;

iii.) he shall, as soon as practicable, assert and collect or settle all claims and rights of the Corporation;

(footnote continued on following page)

other instrument which more specifically delineated the powers to be conferred on the person who might be appointed, such person being described as "the true and lawful attorney and agent of and for [Blair]."

On September 25, 1970, the trustees of the Special Trust Fund made a first advance of $1,000, which triggered the appointment of Patrick E. Scorese as Liquidator. Although the trustees were allegedly prepared to advance a total of $15.9 million, all payments ceased when, four days later, appellees J. P. Foley & Company, Inc., John P. Foley, Jr., its President, and Anita Salisbury, his secretary (hereinafter collectively referred to as Foley), holders of subordinated debentures of Blair, filed an involntary petition in bankruptcy against Blair in the District Court for the Southern District of New York. After answering and demanding a jury trial, Blair and Scorese moved for summary judgment dismissing the petition; Foley cross-moved for a summary adjudication of bankruptcy. Concluding that Blair's consent to the appointment of Scorese as liquidator constituted the fifth act of bankruptcy, Referee Herzog, in a decision dated April 13, 1971, denied the motion of Blair and Scorese and granted Foley's. The Referee's order of adjudication, entered April 27, 1971, stayed all proceedings subject to the order of Referee Lowenthal, who had been put in charge of the case. On April 15th 1971, Blair filed a petition for relief under Chapter XI of the Bankruptcy Act, § 321, and applied for a stay of adminis-

(footnote continued from preceding page)

iv.) he shall pay any claim against the Corporation considered by him to be a valid claim of any customer of the Corporation;

v.) he shall take such other steps as he deems necessary or appropriate to liquidate the business of the Corporation.

It is agreed that consistent with the duty of the Liquidator to effect a fair and orderly liquidation of the business of the Corporation to enable prompt settlement with its customers, the Liquidator shall act in accordance with what he deems to be good business practice.

tration pursuant to § 325. This appeal followed Judge Cooper's denial, on March 15, 1972, of a petition to review the order of adjudication. So far as the record shows, no trustee has been elected and the liquidator has continued to function.

Although Foley's petition had alleged three acts of bankruptcy, no serious attempt was made to support the first two[2] before the referee, in the district court or here. Blair and Scorese argued at length, but without success, that, because of certain special circumstances unnecessary to detail, Foley was not a subordinated creditor but a stockholder. Although we do not find appellants' arguments on this point legally persuasive, we need not decide the issue since we hold that the referee and the district judge erred in concluding that Blair had committed the fifth act of bankruptcy.

Before attempting to construe § 3a(5), it is useful to remind ourselves of the purpose of requiring an act of bankruptcy as a condition to an involuntary adjudication. As said in 1 Collier, Bankruptcy ¶ 3.03, at 403 (rev. ed. 1971) (footnotes omitted):

> This requirement of alleging acts of bankruptcy appears to be peculiar to Anglo-American jurisprudence. In countries following the Civil Law mere cessation of payment by the debtor is sufficient to ground a creditor's petition. Anglo-American law, however, affords protection against arbitrary or unjust interference with the property of the debtor by providing that he shall not be amenable to bankruptcy at the instance of creditors unless he has done, or suffered to be done, certain acts, principally concerning his property.

The underlying philosophy was also explained by the Supreme Court in a decision which, although arising under

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[2] These were an alleged fraudulent conveyance of a management contract with the Blair Fund and undescribed preferential transfers of $5,000,000 to unknown creditors.

an earlier Bankruptcy Act, applies in many respects to the present statute:

> There is nothing in the Bankruptcy Act, either in its language or object, which prevents an insolvent from dealing with his property, selling or exchanging it for other property at any time before proceedings in bankruptcy are taken by or against him, provided such dealing be conducted without any purpose to defraud or delay his creditors or give preference to any one, and does not impair the value of his estate. An insolvent is not bound, in the misfortune of his insolvency, to abandon all dealing with his property; his creditors can only complain if he waste his estate or give preference in its disposition to one over another. His dealing will stand if it leaves his estate in as good plight and condition as previously.

Cook v. *Tullis*, 85 U.S. (18 Wall.) 332, 340 (1874).

It is undisputed that two of the conditions of § 3a(5) were here fulfilled. Blair was insolvent or unable to pay its debts as they matured, and it permitted the appointment of Scorese to "take charge" of its property in the ordinary meaning of that term. But that is not enough unless Blair permitted Scorese to be appointed as "a receiver or trustee." The crucial question is what Congress meant by these words.

The Liquidator did not meet what is usually regarded as essential to the status of a receiver, namely, appointment by a court.

> A receiver is an indifferent person between the parties to a cause, appointed by the court to receive and preserve the property or fund in litigation *pendente lite*, when it does not seem reasonable to the court that either party should hold it. He is not the agent or representative of either party to the action, but is uniformly regarded as an officer of the court. . . .

High, A Treatise on the Law of Receivers, ch. 1, § 1, at 2-3 (4th ed. 1910); see *Booth* v. *Clark*, 58 U.S. (17 How.) 338, 348 (1855).[1] Just as a receiver is not, without more, an agent, *Ledbetter* v. *Farmers Bank & Trust Co.*, 142 F.2d 147 (4 Cir. 1944), so an agent, even one with powers as extensive as Scorese's, is not, without more, a receiver. The Liquidator also lacked one element essential to the normal concept of trusteeship, namely, legal title to the property. See Restatement of Trusts, 2d, §§ 2 and 8 & comment *a*. (1959). In this respect the case differs essentially from *In re Bonnie Classics, Inc.*, 116 F. Supp. 646 (S.D.N.Y. 1953), on which the referee and the district court mistakenly relied. Judge Weinfeld there held, with obvious correctness, that the filing of a certificate of dissolution under then § 105 of the New York Stock Corporation Law was an act of bankruptcy under § 3a(5), for the very reason that legal title " 'was vested in the directors as trustees for creditors and stockholders.' " *Id.* at 648.

To look at the matter somewhat more broadly, receivership and trusteeship both entail the consequence, as does the fourth act of bankruptcy, "a general assignment for the benefit of creditors," that creditors cannot pursue their ordinary remedies against the debtor and his property but are relegated to proceeding, in one way or another, with respect to the assignee, receiver or trustee. By establishing the fourth and fifth acts of bankruptcy, Congress made a policy determination that when an insolvent debtor, even with the best of motives, has placed such obstacles in the way of creditors, the latter should be able to invoke a federal statutory procedure which includes the right to choose their own trustee. See *Globe Ins. Co.* v. *Cleveland Ins. Co.*, 10 Fed. Cas. 488, 492 (No. 5486) (C.C.N.D. Ohio

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[1] There are instances in which the term receiver is used to describe a party who has not been appointed by a court. See 1 Clark, A Treatise on the Law and Practice of Receivers § 11 (3d ed. 1959). However, none of the exceptions to the normal usage of the term, see, *e.g.*, 12 U.S.C. § 191, are applicable to this case.

1876), *appeal dismissed*, 98 U.S. 366 (1879). On the other hand, the mere grant of a power of attorney "for the purpose of winding up the affairs" of a corporation is not an assignment for the benefit of creditors and thus does not constitute the fourth act of bankruptcy, *In re Ambrose Matthews & Co.*, 229 F. 309 (D.N.J.), *aff'd*, 236 F. 539 (3 Cir. 1916), since nothing prevents a creditor from pursuing his ordinary remedies. If the grant of such a power of attorney does not constitute the fourth act of bankruptcy, we fail to see why it should constitute the fifth when the words used by Congress would not normally lead to that result.[4]

This conclusion is reinforced by the history of the statute, which the referee and the district court did not discuss. While the Bankruptcy Act of 1898 made a general assignment for the benefit of creditors a fourth act of bankruptcy, 30 Stat. 546, it contained no provision corresponding to the present fifth act. To reconcile a conflict of decisions as to whether the appointment of a receiver or trustee was nevertheless within the fourth act, see statement of the Attorney General, H.R. Doc. No. 9, 58th Cong., 2d Sess. 125 (1903), the Act of February 5, 1903, 32 Stat. 797, added the words "or, being insolvent, applied for a receiver or trustee for his property or because of insolvency a receiver or trustee has been put in charge of his property under the laws of a State, of a Territory, or of the United States." The effect of the amendment was greatly impaired by the holdings of a number of courts that Congress had used the term insolvency in the bankruptcy sense. See, *e.g*, *In re Wm. S. Butler & Co*, 207 F. 705 (1 Cir.), *cert. denied*, 231 U.S. 752 (1913); *In re Valentine Bohl Co.*, 224 F. 685 (2 Cir. 1915). Some courts had sought to soften the blow by holding that it sufficed under the second clause if the debtor was in fact insolvent in the bankruptcy sense even

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[4] The only case supporting the conclusion below is *In re R. V. Smith Co.*, 38 F. Supp. 57, 62 (W.D. Okla. 1941); we do not find its reasoning to be persuasive.

though the petition had alleged only inability to pay maturing debts. See *Davis* v. *Michigan Trust Co.*, 2 F.2d 194, 196 (6 Cir. 1924) (Mack, J.), *aff'd sub nom. Mellon* v. *Michigan Trust Co*, 271 U.S. 236 (1926), and cases there cited.

In the 1926 amendments to the Bankruptcy Act, Congress adopted the latter decisions by rewording the clause added in 1903 to state, somewhat ungrammatically when read in conjunction with the section's preamble, "or, while insolvent, a receiver or trustee has been appointed, or put in charge of his property." 44 Stat. 663. See H.R. Rep. No. 695, 69th Cong., 1st Sess. 4 (1926); H.R. Rep. No. 877, 69th Cong., 1st Sess. 7 (1926); Colin, An Analysis of the 1926 Amendments to the Bankruptcy Act, 26 Colum. L. Rev. 789, 792 (1926); and McLaughlin, Amendment of the Bankruptcy Act, 40 Harv. L. Rev. 341, 366-68 (1927). The Senate bill, S. 1039, had retained the words "under the laws of a State, of a Territory, or of the United States," see 67 Cong. Rec. 6800 (1926), but the Senate managers consented to their being stricken in the conference, the House managers stating that the "difference consists merely in phraseology," H.R. Rep. No. 1257, 69th Cong., 1st Sess. 8 (1926). The House hearings provide further evidence that the removal of the language was not meant to affect the substance. See Hearings Pursuant to H. Res. 353 on Revision of the Bankruptcy Law Before the House Comm. on the Judiciary, 68th Cong., 2d Sess., ser. 51, at 38-39 (1925); Hearings on H.R. 5221 and H.R. 8119 Before the House Comm. on the Judiciary, 69th Cong., 1st Sess., ser. 4, at 17 (1926). In fact, the words had always been surplusage. A receiver appointed to take charge of a debtor's property is necessarily appointed "under the laws of a State, of a Territory, or of the United States," and a trustee would either be so or would be a common law assignee under the fourth act of bankruptcy—unless the insolvent had appointed him otherwise than for the benefit of all creditors in which case the transaction

would be a fraudulent conveyance within the first act or a preference under the second. The 1926 amendment thus affords no indication that Congress meant "a receiver or trustee" to include a person who had some but not all of the historic attributes of these officers.

The courts continued to read the requirement of insolvency under the 1926 amendment in the bankruptcy sense. See 1 Collier, Bankruptcy, *supra*, ¶ 3.501, at 496. To overcome this, and also to correct its grammer, Congress, in enacting the Chandler Act, changed the provision to its present form, 52 Stat. 844-45. The Senate Report emphasized that the purpose was to broaden the scope of the fifth act of bankruptcy "in order to reach the widely prevalent abuse of collusive equity receiverships." S. Rep. No. 1916, 75 Cong., 3d Sess. 12 (1938); see also H.R. Rep. No. 1409, 75th Cong., 1st Sess. 6 (1937). Not only was there no indication that Congress meant to extend the words "receiver or trustee" beyond their normal meaning to include a liquidating agent, but § 2a(21), which was added in 1938, 52 Stat. 844, shows that when the draftsmen desired to cover such an agent, they considered it necessary to say so and knew how to do it. Section 2a(21) authorizes a bankruptcy court to "[r]equire receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property" to deliver the property in their possession or control to a representative of the bankruptcy court. In 1952, Congress amended § 69d, to provide that upon the filing of a petition "a receiver or trustee, appointed in proceedings not under this Act, of any of the property of a bankrupt, an assignee for the benefit of creditors of a bankrupt, or an agent authorized to take possession of or to liquidate any of the property of a bankrupt" shall be accountable to the bankruptcy court for any action taken subsequent to the filing of a petition, shall file a schedule of assets and liabilities, shall make a sworn statement of his administra-

tion of the estate, and shall not make any disbursements or take other administrative action without authorization from the bankruptcy court. 66 Stat. 426. The House Committee explained:

> Secion 2a(21) gives the court jurisdiction to require receivers or trustees, appointed in proceedings not under the act, as well as assignees for the benefit of creditors and agents authorized to take possession of or to liquidate a person's property, to deliver the property in their possession or under their control to a receiver or trustee appointed under the act. Section 69d, spelling out that power, requires a receiver or trustee, not appointed under the act, of any property of the bankrupt, to account to the bankruptcy court, but does not include the assignee and agent. The bill adds the necessary language and clarification.

H.R. Rep. No. 2320, 82d Cong., 2d Sess. 15 (1952). Here again Congress manifested its belief that a liquidating agent was neither a receiver nor a trustee.

Foley asks us to disregard all this on grounds of policy, an argument that proved successful with the referee and the district judge.[5] While we doubt that we could justify so great a broadening of the words on such grounds, the policy argument is not sufficiently impressive that we need to consider this. It is essential to bear in mind that the first three acts of bankruptcy—fraudulent conveyances, preferences, and failure to vacate or discharge liens—

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[5] These decisions would obviously have meant the end of the NYSE's Special Trust Fund plan, since the Exchange would scarcely advance funds in order to avert a bankruptcy if the attendant designation of a liquidator would enable the few creditors needed to meet the tests of § 59b, *as amended*, 11 U.S.C. § 95(b), to provoke it. For the future this problem is handled by the Securities Investors Protection Act of 1970, 15 U.S.C. §§ 78aaa, *et seq.* Section 5(b)(1)(A)(ii) and (iii) of SIPC, 15 U.S.C. § 78eee(b)(1)(A)(ii) and (iii), gives some slight added support to our conclusion.

apply as fully to action or inaction by a liquidating agent as by the principal. Foley contends that, despite this, the liquidator may make preferential transfers of which creditors may not be aware, may neglect to pursue claims as vigorously as would a trustee in bankruptcy, or may fail to elicit claims which an examination under § 21a would develop. All this would be equally true if Blair had pursued its plan of self-liquidation. Foley's policy arguments are in reality a contention that Congress took the wrong turn when it required creditors to establish an act of bankruptcy and did not permit them to set the procedures of the Act in motion by a showing of insolvency alone.[8] But Congress made the choice long ago in § 1 of the short-lived Bankruptcy Act of 1800, 2 Stat. 1921, and repeated it in § 1 of the Act of 1841, 5 Stat. 440-42, in § 39 of the Act of 1867, 14 Stat. 536, and in the present statute. A court's duty is to construe what the legislature has said, not to substitute a new and debatable notion of policy which so many Congresses have rejected.

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[8] This position finds some support in legal literature. One commentator, who traced the origins of the Anglo-American requirement of an act of bankruptcy, has concluded that, while the requirement was sensible when the objective of bankruptcy law was to deal with the culpable acts of the debtor, this is no longer so now that the primary concern is with the debtor's financial condition rather than his conduct. Treiman, Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law, 52 Harv. L. Rev. 189, 200 (1938). Nevertheless, he believed that, so long as the present definition of insolvency was retained, elimination of the acts of bankruptcy would be "utterly impractical." *Id.* at 211. Proof of insolvency under the existing definition, which describes an "internal condition" of the debtor, he reasoned, could only be obtained by a comprehensive examination of the debtor's financial situation; the requirement of an act of bankruptcy was thus important in preventing the debtor's financial affairs from being pried into at will. The author therefore felt that insolvency would have to be redefined in terms of an inability to meet obligations as they became due—an "external condition," ascertainable without interference into the debtor's affairs—before the acts of bankruptcy could be eliminated. *Id.* at 211-12. See also Note, "Acts of Bankruptcy" in Perspective, 67 Harv. L. Rev. 500 (1954).

The order of the district court is reversed, with instructions to direct the referee to vacate the adjudication and dismiss the petition.

TIMBERS, *Circuit Judge* (dissenting):

Some nineteen years ago, a wise and comprehending judge, in construing Section 3(a)(5) of the Bankruptcy Act, had this to say:

> "I do not think it is necessary to resort to dictionary definition of 'appointment.' It is not required that the transferee of the property be formally 'appointed' as 'trustee' by a ceremonial document referring to him as such. The method adopted to effect the transfer is immaterial. It is the end result that counts. Any action by one who is insolvent which effectively causes the transfer of his property to another for final liquidation purposes appoints the transferee a 'trustee to take charge of his property' under § 3, sub. a(5). By filing the petition for its dissolution the corporation 'procured, permitted or suffered voluntarily * * * the appointment' of such a trustee. Any other construction would defeat the objectives of the Bankruptcy Act and abort the broad powers of the courts of bankruptcy intended for the uniform administration of insolvent estates." *In re Bonnie Classics, Inc.*, 116 F.Supp. 646, 648 (S.D.N.Y. 1953) (Weinfeld, J.) (footnotes omitted).

While *Bonnie Classics* is distinguishable on its facts from the instant case, nevertheless, in my view, the considerations noted there by Judge Weinfeld should lead to the same result here where a corporation has agreed to the appointment of a liquidator with the power to "take control of the business and property of the Corporation for the purpose of liquidating the business of the Corporation."

The comprehensive legislative history set forth in the majority opinion does not compel the result reached by

the majority. The language in the original Bankruptcy Act of 1898 relied on by the majority remained in the statute until 1926. At that point, a broad revision of the Act was effected, including the elimination of the requirement that the appointment of a receiver be by statute or judicial proceeding. 44 Stat. 663. While the majority correctly notes that the principal focus of the drafters of the amendment was on remedying an ambiguity regarding the preliminary requirement of insolvency, and that the elimination of the necessity of formal appointment was said to be simply a matter of change in phraseology, the majority overlooks the fact that if Congress truly had intended to limit the change to those goals, it surely need not have gone as far as it did. The result, as I see it, is that we are asked to find a narrow purpose behind an Act of Congress, despite the failure of Congress to demonstrate that narrow purpose in the statutory language through the use of drafting devices frequently employed. Where the effect of such a reading is to hold in favor of a party whose position relies on language expressly eliminated from the statute, and thereby to defeat a party whose position falls squarely within the remaining language, I should have thought that we would construe the amendment in the most sensible, rather than the narrowest, manner. As the Supreme Court said in *Shamrock Oil & Gas Corp.* v. *Sheets*, 313 U.S. 100, 107 (1941), if Congress had intended any other reading of the statute, "we can hardly suppose that it would have failed to use some appropriate language to express that intention."

Finally, I think it should be pointed out that, despite the majority's illuminating instruction on the definition of receivership, and its quite proper conclusion that the liquidator did not come within that definition, we are left with the possibility that the liquidator may qualify as a trustee. At least in the jurisprudence of bankruptcy,

> "'*Trustee*' means much the same as 'receiver', the nomenclature varying in different states. *The term is*

also intended, no doubt, to include liquidating agents generally, who, though performing much the same functions as receivers, may not be appointed by a court." 1 Collier on Bankruptcy ¶ 3.502, at 501 (14th ed. 1971) (latter emphasis added).

Cf. *In re R. V. Smith Co.*, 38 F.Supp. 57, 62 (W.D. Okla. 1941).

The issue on this appeal does not lend itself to easy resolution. The approach by the majority cannot be said to be an unreasonable one. I am unwilling, however, to reach a decision on the basis of language that Congress purposefully has removed from the statute, especially in the light of analysis as persuasive as that in *In re Bonnie Classics, Inc., supra.* I therefore respectfully dissent.

APPENDIX B—Opinion of Hon. Irving Ben Cooper, United States District Court, U. S. District Court, Southern District of New York

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

IN THE MATTER

of

BLAIR & CO., INC.,

Bankrupt.

Appearances:

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IRVING BEN COOPER, *D. J.*

The petition to review the determination of Referee in Bankruptcy, Hon. Asa S. Herzog, is denied. The Referee's order is confirmed.

In view of both the form and substance of the debentures issued, the petitioners were creditors of the bankrupt and were authorized to file a petition in bankruptcy under § 59(b) of the Bankruptcy Act, (Act) 11 U.S.C. § 95(b). New York Stock Exchange Rule 325; Cf. *Goldstein* v. *Wolfson*, 132 F.2d 624, (2d Cir. 1942).

Referee Herzog correctly determined that Blair was "insolvent" within the meaning of Section 1(19) of the Act, 11 U.S.C. § 1(19) on September 25, 1970. The conclusion was fully justified on all the evidence before him. In particular, no triable issue of fact was created as to the alleged facts contained in the balance sheet which, in our opinion, was properly considered and weighed. See *Huron Milling* v. *Hedges*, 257 F.2d 258, 262 (2d Cir. 1958); *Smith* v. *Bear*, 237 F.2d 79 (2d Cir. 1956); Fed. R. Civ. P. 56; Rule 801(d)(2), Revised Draft of Proposed Rules of Evidence for the United States Courts and Magistrates (March 1971); Minutes, March 11, 1971, pp. 40-41.

The appointment of the Liquidator by the New York Stock Exchange and his taking of "control" was an act of bankruptcy within the meaning of § 3(a)(5) of the Act, 11 U.S.C. § 21. We agree with the formulation of this concept by our Judge Weinfeld in *In Re Bonnie Classics*, 116 F.Supp. 646 (S.D.N.Y. 1953):

> "It is not required that the transferee of property be formally 'appointed' as trustee by a ceremonial document referring to him as such. The method adopted to effect the transfer is immaterial. It is the end result that counts. Any action by one who is insolvent which effectively causes the transfer of his property to another for final liquidation purposes appoints the transferee a trustee to take 'charge of his property' under Section 3, Sub. a(5)."

Illinois v. *Campbell*, 329 U.S. 362 (1946); see also, *In Re Hayes*, 127 F.Supp. 514 (D.C. Alaska 1955); 1 Collier on Bankruptcy §§ 3.502, 3.503, at 501-503 (14th Ed. 1971); 1 Remington on Bankruptcy § 157 at 247, § 160 at 249.

We decline to create an exemption from the Act for insolvent brokerage corporations which privately seek to wind-up their affairs pursuant to an agreement between themselves and a stock exchange. Cf. *In re Watts & Sacks*, 190 U.S. 1,27 (1902). As Referee Herzog correctly noted, such would "defeat the objectives of the Act and abort the broad powers of the court of bankruptcy intended for the uniform administration of insolvent estates" as well as "provide an effective means to defeat the exclusive jurisdiction of the bankruptcy courts by denying creditors the right to select their own trustee to effectuate liquidations." Opinion of Referee Herzog, April 13, 1971, p. 11. See *Bonnie Classics, supra*, at 648.

So ordered:

New York, N.Y.
March 15, 1972

Irving Ben Cooper
United States District Judge

APPENDIX C—Opinion of Hon. Asa S. Herzog, Referee in Bankruptcy

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

IN THE MATTER

of

BLAIR & CO., INC.,

Bankrupt.

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MR. PATRICK E. SCORESE
Liquidator

ASA S. HERZOG, *Referee:*

Blair & Co., Inc. ("Blair"), the bankrupt above named, is a Delaware corporation engaged in the general brokerage and commission business as a registered broker-dealer, with principal offices in New York City. It was a member of the New York Stock Exchange, American Stock Exchange, and Midwest Stock Exchange.

Prior to September 29, 1970, bankrupt was engaged in the "contraction and liquidation of its business and properties" and with the exception of a record-keeping office all of its branch offices were either closed or surrendered to other broker-dealers. The services of its registered representatives (with minor exceptions) were terminated and "efforts were undertaken" to transfer and deliver the accounts of public customers to other broker-dealers or to the customer. (Affidavit of A. George Saks, a vice-president of Blair, in support of the motion to dismiss, ¶ 6.)

On September 21, 1970, the bankrupt and its directors and voting stockholders entered into a written agreement with the New York Stock Exchange ("Exchange") whereby at their absolute discretion, the trustees of a Special Trust Fund set up by the Exchange would from time to time make loans to the bankrupt to provide direct and indirect assistance to bankrupt's customers threatened with loss of their money or securities because of bankrupt's financial condition.

Paragraph designated "VI" of said agreement provided that "from and after" the first loan or guarantee by said Trustees, or the first payment by the Trustees to any of bankrupt's creditors, is made, the Exchange shall have the right to appoint such person as it may choose as "Liquidator of the business" of the bankrupt, such Liquidator to serve until such time as all powers of attorney executed by the corporation or voting stockholders are terminated by the Exchange.

The paragraph of the said agreement designated "VIII" provides:

> "Immediately following his appointment by the Exchange, the Liquidator shall take control of the business and property of the Corporation for the purpose of liquidating the business of the corporation and shall proceed as follows in connection with the liquidation:
>
> "i) he shall promptly take such steps as he may deem practicable to reduce the Corporation's operating expenses and to dispose of the Corporation's saleable assets;
>
> . . . . .
>
> "iii) he shall, as soon as practicable, assert and collect or settle all claims and rights of the Corporation;
>
> "iv) he shall pay any claim against the Corporation considered by him to be a valid claim of any customer of the Corporation;
>
> "v) he shall take such other steps as he deems necessary and appropriate to liquidate the business of the Corporation;
>
> "It is agreed that consistent with the duty of the Liquidator to effect a fair and orderly liquidation of the business of the Corporation to enable prompt settlement with its customers, the Liquidator shall act in accordance with what he deems to be good business practice."

Pursuant to the aforesaid agreement and on September 25, 1970, the Exchange appointed Mr. Patrick E. Scorese as Liquidator (Saks affidavit, ¶ 7) and he entered upon his duties in accordance with the terms and provisions of said agreement. The Liquidator, Mr. Scorese, is one of the moving parties herein.

On September 29, 1970, four days after appointment of the Liquidator as aforesaid, an involuntary petition was

filed against Blair by J. P. Foley & Company, Inc., John P. Foley, Jr., and Anita Salisbury. Mr. Foley is principal of J. P. Foley & Company, Inc., and apparently Anita Salisbury is Mr. Foley's secretary.

The involuntary petition alleged three acts of bankruptcy [Bankr. Act § 3a, 11 U.S.C. § 21a], as follows:

> "Within four months next preceding the filing of this petition, the alleged bankrupt committed an act of bankruptcy in that the alleged bankrupt did heretofore,
>
> "(a) on or about the 10th day of August, 1970, with intent to hinder, delay and defraud its creditors, convey, transfer, conceal, remove, or permit to be concealed or removed, or set over unto said divers persons, whose names are unknown to your petitioners, valuable property, consisting of a management contract of the Blair Fund of the value of $1,000,000.
>
> "(b) while insolvent transfer property and various moneys amounting in the aggregate to the value or sum of $ to various creditors with intent thereby to prefer such creditors over other creditors of the same class, the names of the creditors receiving such preference being unknown to your petitioners.
>
> • • • • •
>
> "(f) while insolvent and unable to pay its debts as they mature, procure, permit, or suffer voluntarily or involuntarily the appointment of Patrick E. Scorese as Receiver (or Liquidator) of the assets of the alleged bankrupt and said Receiver (or Liquidator) was put in charge of the property of the alleged bankrupt on the 28th day of September 1970."

The bankrupt, Blair, interposed an answer to the involuntary petition in bankruptcy denying the material alle-

gations thereof and made written demand for trial by jury. [Bankr. Act § 19; 11 U.S.C. § 42]

Thereafter the Liquidator, Mr. Scorese, and the bankrupt, Blair, moved, pursuant to Fed.R.Civ.P. 56, for summary judgment dismissing the involuntary petition. The petitioning creditors opposed the motion, and cross-moved for summary judgment adjudicating Blair a bankrupt.

By notice of motion dated October 30, 1970, the petitioning creditors moved to amend the second act of bankruptcy alleged in the said involuntary petition by inserting the figure $5,000,000. in the blank space appearing in the allegation of said act of bankruptcy.

By notice of motion dated October 27, 1970, petitioning creditors moved for an order, pursuant to Sections 3d and 21a of the Bankruptcy Act, requiring the bankrupt to appear for deposition upon oral examination and requiring the bankrupt and the Liquidator to produce at said examination books and records relating to the issues presented by the petition and answer.*

By order of Chief Judge Sidney Sugarman, dated February 2, 1971, the aforesaid motions were referred to the undersigned for hearing and determination.

The motion for summary judgment dismissing the involuntary petition will be considered first. The moving parties argue first, that no act of bankruptcy was committed upon which an involuntary petition can be predicated, and second, that the petitioning creditors are in fact investors and not creditors, and consequently, ineligible to file the said petition.

The first act of bankruptcy charged in the transfer (with intent to hinder, delay and defraud creditors) of "valuable property" consisting of a management contract of the Blair Fund of the value of $1,000,000.

The Saks affidavit states that Blair was not a party to the management contract with Blair Fund, a publicly

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* In view of the disposition of the motion and cross-motion for summary judgment, this motion is rendered moot.

owned mutual fund. This contract, it is averred, is or was an asset of Blair Advisory Co., Inc., a Delaware corporation and subsidiary of the bankrupt. Furthermore, it is alleged, due to action of the Board of Directors of Blair Fund, a proposed sale of the capital stock of Blair Advisory Co., Inc. was never effected, and the latter company remained the owner of the management contract referred to in the alleged act of bankruptcy. (Saks affidavit, §§ 12-14 inclusive.)

The foregoing is not controverted by the petitioning creditors and as a matter of fact, on the argument before me counsel for the petitioning creditors indicated no reliance upon this alleged act of bankruptcy to sustain the petition (SMP 44).

Nor did counsel lean heavily on the second act alleged. The allegation of preferential transfers is in the barest language of the statute and susceptible to a motion to strike. Indeed, the allegation is so barren of facts that it does not lend itself to amendment. It fails to name the recipients of the transfers, it does not specify the subject matter of the transfer, except that it was "property and various moneys," and it neglects to state the value or sum of the property and money transferred. There is simply nothing to amend. It is so colorless that amendment would not be an amplification, but a replacement. This is clearly distinguishable from *Glint Factors* v. *Schnapp*, 126 F.2d 207 (2d Cir. 1942) in which it was charged that transfers were made to "relatives" of a sum exceeding $2,300. An amendment would necessarily have to invoke the relation back doctrine in order to fall within the four-month period during which otherwise innocuous preferences become acts of bankruptcy. The lack of any descriptive detail to show that a particular transfer was charged or even intended, makes the relation back doctrine utterly inapplicable in this case, *Divorsky* v. *Alanjay Bias Binding Corp.*, 182 F.2d 809 (2d Cir. 1950), and therefore it would be impossible to allege as an act of bankruptcy a preferential transfer that could withstand attack.

Accordingly, the motion to amend is denied and the second act of bankruptcy alleged in the petition is found insufficient in law.

The third act of bankruptcy alleged, the appointment of the Liquidator, however, falls squarely within Bankruptcy Act § 3a(5) [11 U.S.C. § 21a(5)] and must survive bankrupt's attack.

Bankr. Act § 3a provides that acts of bankruptcy by a person shalll consist of his having

> "(5) while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily, or involuntarily, the appointment of a receiver or trustee to take charge of his property;"

The bankrupt and Liquidator argue that the type of receiver or trustee referred to in § 3a(5) of the Act is one who is judicially appointed or is appointed in accordance with the provisions of statutory law. I am unable to agree that taking control by the Liquidator is not taking "charge" of the bankrupt's property within the meaning of § 3a(5) and I reject that argument.

> "It is not required that the transferee of property be formally 'appointed' as trustee by a ceremonial document referring to him as such. The method adopted to effect the transfer is immaterial. It is the end result that counts. Any action by one who is insolvent which effectively causes the transfer of his property to another for final liquidation purposes appoints the transferee a trustee to take 'charge of his property' under Section 3, Sub. a(5)." *In re Bonnie Classics*, 116 F.Supp. 646 (S.D.N.Y. 1953).

The Liquidator, Mr. Scorese, took "control of the business and property" of the bankrupt for the express purpose of liquidating it with power to take such "steps as he deems necessary and appropriate to liquidate the business"

of the bankrupt. He is empowered to "dispose of the Corporation's saleable assets." He is authorized to "collect and settle all claims" and pay what he considers valid claims of any customer of the bankrupt.

As I construe the agreement of September 21, 1970, under which Mr. Scorese was designated as Liquidator, he had exclusive possession and control of bankrupt's assets at all times after he took charge. The powers he was authorized to exercise were not less than those of a court-appointed receiver or trustee. He exercised complete dominion and his possession divested the officers and directors of Blair of possession and control of the company's assets. His duty was to proceed to liquidate and wind up the affairs of the bankrupt and to distribute its assets to those entitled thereto.

Any other view of the role of the Liquidator in this case would provide a convenient way to exclude insolvent corporations from the scope of the Bankruptcy Act through winding-up proceedings worked out privately between a broker and the Stock Exchange. Cf. *In re Watts & Sacks*, 190 U.S. 1, 27. Any other construction would defeat the objectives of the Act and abort the broad powers of the court of bankruptcy intended for the uniform administration of insolvent estates. Were I to uphold Blair's and the Liquidator's contention, it could provide an effective means to defeat the exclusive jurisdiction of the bankruptcy courts and deny creditors the right to select their own trustee to effect liquidation.

> "It would provide a neat way for derelict directors to gain immunity from investigative and discovery techniques and summary procedures set up under the Act. It would deprive creditors of the comprehensive powers under the Act aimed at the expeditious recovery of assets which may have been diverted or transferred from an insolvent estate." *In re Bonnie Classics*, 116 F. Supp. 646, *supra*.

I hold that the taking of "control" by the Liquidator was an act of bankruptcy within the meaning of § 3a(5) of the Bankruptcy Act.

The second contention of the bankrupt and of the Liquidator is that the petitioning creditors are not in fact creditors and are therefore ineligible to act as petitioning creditors.

The Saks affidavit avers that on April 3, 1970, John P. Foley, Jr., acting for himself, the other petitioning creditors, and Anne A. Foley, entered into an agreement with Blair, pursuant to which each made "investments" in Blair which were "characterized as subordinated loans." (Saks affidavit §§ 34, 35)

It is the nature of this transaction which gave rise to the unique situation now presented. Foley executed a "collateral agreement" and secured note in the sum of $3,784,349, both dated April 3, 1970. The secured note was collaterized by marketable securities, pledged concurrently with the execution of the note. The general scheme of the transaction, reduced to its simplest terms, was this: if Blair's call for payment on the note was met, Blair would issue to Foley a subordinated debenture in like amount; on the other hand, if Blair's call for payment went unheeded, Blair could liquidate the collateral [¶ XI(b) of the Collateral Agreement] and issue the subordinated debenture (¶ IX of said Agreement). This is precisely what occurred and this transaction is what gave rise to the relationship between the parties which bankrupt said made Foley an investor and which Foley says made him a creditor, albeit a subordinated creditor.

The question which presents itself is why this roundabout and rather complicated method, if an investment was intended? Or indeed, why this method of making a loan, if that was the intention of the parties?

The answer, it seems clear to me, is found in the Rules & Policies to the Stock Exchange governing the operation of member organizations, and particularly, those rules

applying to capital requirements. In Rule 325 (referred to in paragraph III(b) of the Collateral Agreement), the Exchange has fixed the capital requirements of its member firms and in effect has set a minimum ratio of capital to debt. It provides that for the purpose of computing the net capital of member firms there may be included "borrowings covered by subordination agreements approved by the Exchange." (Rule 325.15) In practice, therefore, the member firm needing capital borrows money to use as part of its capital requirement under an agreement to repay with interest and a percentage of net income to compensate for the risk involved in subordinating.

The reason for the secured note is that although the member firm has need to have its capital bolstered by the securities behind the note, it has, or may at the moment have, no need for cash. The collateral agreement, therefore, is in effect a commitment to lend money, or if it does not have the money when demand is made, to permit the securities to be converted into cash.

Rule 325.30 permits subordinated liabilities to be shown in a separate section on the liability side of its statement following current liabilities and preceding net worth or capital. It permits such liabilities to be shown, for example, as follows:

"Subordinated Liabilities and Capital:

Liabilities subordinated to claims of general creditors	$.....
Capital (net worth or other acceptable title)	$.....

This practice does not mask the true liabilities of the company as will be shown when the solvency of Blair is discussed, *infra*.

In any event, Rule 325 of the Exchange explains, certainly to my satisfaction, why what was undoubtedly a loan by the petitioning creditors to Blair, became a more or

less complicated and certainly out-of-the-ordinary transaction.

But what emerges from the Collateral Agreement, the secured note and the pledged securities, was a loan to Blair now evidenced by debentures and the debtor-creditor relationship.

The term "debenture" hardly needs a dictionary definition. But, according to Black's Law Dictionary (3d ed.), it consists of any instrument which either creates or agrees to create a debt in favor of one person or corporation, or several persons or corporations, or acknowledges such a debt. Debentures are nothing more than notes representing indebtedness, not ordinarily secured. 6a *Fletcher Cyclopedia Corporations* (1968 ed.) § 3635. A debenture is simply an unsecured promissory note. *G.M.A.C.* v. *Higgins*, 161 F.2d 593 (2d Cir. 1947), *cert. denied*, 332 U.S. 810 (1947).

An examination of the subordinated debenture here shows all the characteristics and earmarks of a subordinated promissory note.

Firstly, there is the fixed interest rate: the prime rate of interest in New York City, but not less than 6% per annum, payable semi-annually on fixed dates. It is common knowledge that it is not at all unusual to have interest rates keyed to the prime rate. The provision for a contingent additional return of not more than 2% per annum if net income for such purpose is available is again not unusual, and, as hereinabove indicated, serves as a compensation for the risk of subordinating the loan to other creditors.

Secondly, there is a fixed maturity date, the holder having the right to demand payment on the principal in full (or in multiples of $1,000.) two and one half years after April, 1970, or on any date thereafter on thirty days written notice. Of course, payment may be made only if the corporation is solvent, a condition to be expected since

the debenture is subordinated and subject to prior payment in full of other creditors not so subordinated.

Thirdly, there is provision for acceleration upon default in payment of principal, insolvency, commission of an act of bankruptcy, general assignment for the benefit of creditors or appointment of a receiver for all or a substantial part of the corporation's property.

Finally, throughout the debenture and the Collateral Agreement language is used which expresses the relationship of the parties in terms of a creditor-debtor situation. The debenture does not contain convertible features and thus the question of whether or not it can be held to be an "equity security" simply does not arise in this instance. Cf. *Chemical Fund, Inc.* v. *Xerox Corp.*, 377 F.2d 107, 110 2d Cir. 1967).

I hold as a matter of law that the petitioning creditors were not capital investors but were creditors who loaned money to Blair for which they received the subordinated debentures.

The bankrupt and the Liquidator cite, in support of their contention, cases determined by the tax court but I do find these to be inapposite. The purpose of the inquiry in the tax cases frequently differs from the purpose of the inquiry in bankruptcy. The Tax Courts are faced with situations where so-called advances are in reality contributions to capital, and therefore, not bona fide debts which may be taken as tax losses.

The bankruptcy situation is entirely different. The circumstances of loans to a company which subsequently becomes bankrupt, may result in their being *treated* as capital investments for the purpose of subordinating them to the claims of other creditors, but they are none-the-less treated as creditors entitled to participate in dividends in the event other creditors are paid in full.

But a creditor who subordinates his claim to those of other creditors does not cease to be a creditor, *Goldstein* v. *Wolfson*, 132 F.2d 624 (2d Cir. 1942), and I know of no

case, nor has one been cited to me, which holds that a subordinated creditor cannot be a petitioning creditor.

In re Itemlab, Inc., 197 F.Supp. 194 (E.D.N.Y. 1961) (reversed on other grounds, 353 2d 149) cited by bankrupt does not bolster its petition, merely holding that the subordinated creditor is not entitled to vote his claim on the question of acceptance of an arrangement since it "would repose in the inferior creditor the power to use his vote to determine how the superior creditor shall collect a claim in which the inferior creditor no longer has an interest." There is obviously distinction between the issue decided in *Itemlab* and that presented in the case *sub judice*. It is one thin gto say that a subordinated creditor may not vote his claim in a Chapter XI proceeding, and quite another to say that by reason of subordination of their claims creditors are disqualified from acting as petitioning creditors.

Section 59b of the Act (11 U.S.C. § 95b) says that three or more creditors holding provable claims not contingent as a liability against a person, amounting in the aggregate to $500. in excess of the value of any securities held by them, may file a petition to have him adjudged a bankrupt.

Provable claims are set forth in § 63a of the Act (11 U.S.C. § 103) which provides:

> "a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by . . . an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not . . . ."

It seems perfectly clear to me that the petitioning creditors have provable claims which entitled them to file the involuntary petition in bankruptcy.

The bankrupt makes what I deem a specious argument to the effect that since it has not yet been ascertained that Blair is unable to pay all its liabilities, it cannot be stated at this juncture that petitioners have suffered any loss. It is conceivable, so the argument runs, that liquidation may

result in the satisfaction of all creditors' claims, including those of the "so-called subordinated lenders." Ergo, it is concluded, the claims of the petitioning creditors are contingent and they do not qualify as petitioning creditors.

This is to fly in the face of all reality. The voluntary liquidation of Blair, the intervention of the Stock Exchange, and the making available of the Exchange's Special Trust Fund to assist in making customers whole all bespeak an insolvency which reduces the likelihood of the subordinated debenture holders realizing any significant amount of their claims to such an extent that it cannot be given any weight. Moreover, as will be indicated, *infra*, Blair was and is seriously and grossly insolvent and not by any fiction can the claims of the petitioning creditors be said to be contingent.

I conclude, therefore, that the petitioning creditors are qualified to file the involuntary petition herein within the meaning of Section 59b of the Act. I have found that an act of bankruptcy has been properly alleged within the meaning of § 3a(5) of the Act. Accordingly, the motion for summary judgment dismissing the involuntary petition is denied.

I turn now to the cross-motion for summary judgment adjudging Blair a bankrupt.

The facts constituting the fifth act of bankruptcy under § 3a of the Act are not denied. Mr. Scorese was, with the consent of the bankrupt, and within the prescribed four-months period, put in charge of its property and his duties and powers are set forth in the exhibits attached to the moving papers. The only question left is whether Blair was insolvent at the time, as required by § 3a(5). I hold that it was.

Attached to the cross-motion is Exhibit I consisting of a balance sheet of Blair as of June 30, 1970, two months and twenty-one days before the appointment of the Liquidator. The accuracy of this statement is not challenged. It indicates assets of $82,290,980.75. It indicates liabilities as follows:

"TOTAL CURRENT LIABILITIES		$ 72,259,737.78
CAPITAL AND SUBORDINATED BORROWING:		
Subordinated borrowings		
Debentures	$ 13,937,819.00	
Secured Demand Notes	6,320,128.00	
		20,257,947.00
Capital Stock and Surplus (deficit)		10,226,704.03
Total		10,031,242.97
TOTAL LIABILITIES & CAPITAL		$ 82,290,980.75"

It is instantly apparent that in accordance with Rule 325 of the Exchange, discussed *supra*, $20,257,947.00 has been set up in a separate category together with capital, which may create the illusion that Blair's assets exceed liabilities by $10,000,000.

This may be perfectly legitimate and sound accounting practice, but the Bankruptcy Court is not bound by the Rules of the Stock Exchange nor by the accounting practices it countenances.

Bankruptcy Act § 1(19) provides:

> "A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of its property, exclusive of any property which he may have conveyed, transferred, concealed, removed or permitted to be concealed or removed, shall not at a fair valuation be sufficient in amount to pay his debts;"

This clear-cut definition cannot be defeated by an accounting practice which places subordinated borrowings and secured demande notes in the same category with capital. Indeed, the financial statement itself recognizes the debentures as "borrowings," albeit subordinated. Applying the bankrutcy definition it appears uncontroverted that on June 30, 1970, Blair's liabilities exceeded its assets

by $10,000,000. The situation, if not worsened on September 21, 1970, when the Liquidator was appointed, and on September 29, 1970, when the involuntary petition was filed, was at the very best, unchanged. Certainly, nothing which would lead to a contrary conclusion appears in the papers on the motions and the exhibits annexed thereto.

Accordingly, I conclude as a matter of law that the bankrupt was insolvent within the bankruptcy definition when the act of bankruptcy was committed and when the petition was filed.

It appears that within the four-month period and while insolvent, the bankrupt committed the fifth act of bankruptcy; that it was insolvent when the involuntary petition in bankruptcy was filed; and that the petitioning creditors are not disqualified from acting as petitioning creditors. Accordingly, there is no genuine issue as to any material fact to be tried. The petitioning creditors are entitled to summary judgment as a matter of law decreeing that Blair be adjudged a bankrupt.

Settle order upon three days' notice in conformity with the foregoing.

Dated: New York, New York, April 13, 1971.

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REFEREE IN BANKRUPTCY